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SIPDIS

TREASURY FOR FTAT, OFAC, OCC/EILEEN SIEGEL, AND OASIA/ICB/VIMAL ATUKORALA
TREASURY PLEASE PASS TO FEDERAL RESERVE AND FINCEN
TREASURY ALSO PASS TO SEC/E.JACOBS
JUSTICE FOR DOJ/CRM/ATMLS AND FOR OIA/RICHARD OWENS
FBI FOR CID

E.O. 12958: N/A
TAGS: EFIN AU
SUBJECT: Austria's Financial Market Supervision Reform

REF: 07 VIENNA 0117 and previous

¶1. SUMMARY: On January 1, 2008, a reform of Financial Market Supervision took effect in Austria. A reaction to several banking scandals, the reform gives the Austrian National Bank (OeNB) sole responsibility for on-site inspection of banks and data analysis while all other functions remain with the Financial Market Authority (FMA) including overall responsibility for bank supervision, regulation, enforcement, and all oversight of non-bank financial institutions. Party politics blocked a more sweeping reform to enhance the powers of the FMA. END SUMMARY.

Banking Scandals Necessitated Reform

¶2. The reform came in reaction to several banking scandals involving BAWAG (reftel), Hypo Alpe Adria, and the AMIS investment fund. Even though many problems resulted from a time before the FMA was established, the GoA had to react in the wake of the scandals and Audit Court recommendations to make financial market supervision "more powerful and efficient" and to address redundancies and poor cooperation between the FMA and the OeNB.

Reform Strengthens Role of Austrian National Bank

¶3. The reform strengthens the role of the Austrian National Bank (OeNB). Prior to January, most supervisory functions were concentrated in the FMA, which delegated to the OeNB audits of credit and market risks. Under the new legislation, the OeNB has sole responsibility for on-site inspections of banks and for the analysis of data from individual institutes. This should avoid redundancies between the FMA and the OeNB. The FMA will continue to be an integrated, independent and autonomous supervisory authority for the entire financial market. The FMA retains overall responsibility for bank supervision (in particular for licensing, regulation, and enforcement) and full responsibility for the non-bank area.

¶4. An important element of the new FMA-OeNB cooperation is that the two will share supervisory findings. The OeNB is obliged to notify the FMA of any significant change in a bank's risk profile and suspected violations of legal requirements. Based on the analysis and audit results, the FMA will then become active as an authority and take appropriate action. Both the FMA and OeNB are increasing staff resources to allow more frequent and deeper auditing of banks, particularly large banks, and other financial institutions subject to FMA supervision.

¶5. Additional reforms to strengthen corporate governance in financial market institutions:
-- a "fit and proper" test for supervisory board chairman
-- a two-year "cool-off period" when moving from an operational role

on the executive board to chairing the supervisory board,
-- stronger internal audit provisions
-- more stringent reporting obligations for auditors to the supervisory board and
-- external rotation of balance-sheet auditors.

¶6. With respect to securities supervision, the FMA will significantly enlarge its staff for more on-site inspections of investment services providers and to meet the extensive requirements of the Securities Supervision Act of 2007, which transposed the EU Markets in Financial Instruments Directive (MiFID) into Austrian law, and a 2007 amendment to the Stock Exchange Act, which distinguishes between operating regulated markets (managed by a market operator in Austria or in an EU member state) and Multilateral Trading Facilities (MTF) requiring a license from the FMA. With respect to insurance and pension supervision, the FMA will apply more frequent stress tests and intensify on-site inspections.

COMMENT

¶7. For political reasons, the reform still divides responsibilities between FMA and OeNB (albeit with clearer boundaries) rather than concentrating supervision in one agency with stronger powers.
The reform fell short of hopes by failing to:
-- Abolish the redundant function of state commissioners, who attend supervisory board meetings of banks with assets over Euro 1 billion,

-- Give the FMA more investigative powers such as search/seizure
-- Introduce higher penalties, as recently advocated by FMA co-CEO Kurt Pribil,

-- Protect supervisors from legal harassment (currently, the authorities or their representatives may be sued for even minor negligence in supervision and enforcement).

¶8. How well the new oversight system works will be clear only when the next problem case puts it under stress. The appointment of new FMA co-CEOs Kurt Pribil and Helmut Ettl bodes well for improved cooperation, since both come from the OeNB.

GIRARD-DICARLO